A 7000-3

THE INADEQUACY OF PROFITS

- TO MODERNIZE COMMERCIAL AND INDUSTRIAL BUILDINGS AND MACHINERY;
- TO CONSERVE ENERGY USAGE;
- TO IMPROVE THE PRODUCTIVITY OF ALL WORKERS AND BUSINESS PEOPLE;
- TO IMPROVE THE AMERICAN STANDARD OF LIVING -- MORE ADEQUATE SHELTER, FOOD AND CLOTHING;
- TO REDUCE INFLATION.

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AUGUST 1979

THE INADEQUACY OF PROFITS

The Federal government's data clearly indicate that profits are holding down inflation and not adding to inflation.

The U.S. Commerce Department's profits data show that profits are low, which has caused inadequate investment in modern commercial and industrial buildings and machinery; resulting in slower growth of the output of 100 million workers and business people (productivity), resulting in slower growth in people's incomes, resulting in slower growth of adequate housing and other consumer purchases, and resulting in 1 1/2 to 2% higher inflation during 1979.

Second Quarter 1979 Compared With First Quarter 1979

The Commerce Department's release of preliminary Second Quarter 1979 Corporate Profits (see Tables 5 and 6) indicates a pretax profit decline of $6.4 billion or 10.5% annual rate from first quarter of 1979 to the second quarter of 1979 (Table 1: Line 1). After the Commerce Department's adjustments for Corporate Income Tax Liability (Line 2: -$3.1 billion), overstatement of profits from inventory valuation (Line 4: $3.3 billion) and from capital consumption allowances (Line 5: -$0.2 billion), profits from current production declined by $0.3 billion, or declined at an annual rate of 1.4% (Line 6). After adjusting for inflation, profits declined at an annual rate of 11.0% (Line 7). After adjusting for the modest increase in output of goods and services, profits declined by 7.5% (Line 8).

In marked contrast, compensation for employees per-unit-of-output increased by 1.5%. Unit profits from current production helped hold down the rate of inflation and did not contribute to inflation.

Last Four Quarters Compared With Preceding Four Quarters

Profits from current production per unit of output (Table 3: Line 8) during the last 4 quarters (3rd and 4th quarters of 1978, and first and second quarters of 1979) compared with the preceding four quarters (3rd and 4th quarters of 1977, and first and second quarters of 1978) declined about 2%, clearly indicating profits were not a cause of high inflation but rather an anchor holding down inflation caused elsewhere.

Calendar Year 1978 Compared With 1977

Profits from current production per unit of output declined 4% from 1977 to 1978 (Table 4: Line 8) and is expected to decline by about 11% when comparing 1979 to 1978.

Future Quarters

Not only have profits per unit of output helped to fight inflation but profits are forecast to do the same during the remaining two quarters of 1979 and during 1980 (see Tables 1, 2, 3 and 4).

Low Profits Mean Low Investment

Profits from current production per unit of output have been so low as to discourage investment in modern machines and buildings. President Carter's Council of Economic Advisers stated in their most recent Economic Report: "The most important inducement for investment is the prospect of future profits from future sales." (page 127).

Profits from current production per-unit-of-output (as measured by profits as a percent of Gross National Product) have been declining during the last 15 years and this trend is forecast to continue. Between 1954 and 1966, after-tax profits from current production averaged about 6% of Gross National Product. Since 1964, this average has decreased to about 3 1/2% of GNP and is forecast to decline even further to below 3% of GNP during the next 18 months (Chart 1). This is dramatically shown by comparing the two longest economic recoveries during the last 25 years, 1961-65 and 1975-79 (Chart 2).

Effective Corporate Tax Rate Is Increasing To Record Levels

After-tax profits from current production are declining because the effective corporate tax rate has increased on a trend from 45% in 1972 to 53% in 1978, 55% during the first and second quarters of 1979 and 57% by the end of 1979 and through 1980 (Chart 3). The anemic $5 billion tax relief intended to encourage investment last year has not changed this discouraging trend significantly.

The increase in effective Corporate Taxes is sharply illustrated by comparing the economic recovery of the 1960's and the mid-1970's (Chart 4).

Employees and Business People Are Working With Less Efficient Buildings And Equipment

In large part because of lower profits from production and higher effective tax rates, capital stock (e.g. modern commercial and industrial buildings and machinery) per employee and business person has declined since 1975 and is forecast to remain low for the foreseeable future (Chart 5). The sharp decline is shown comparing the only two long economic recoveries during the last 25 years (Chart 6).

Productivity Growth Has Slowed Causing Slower Growth Of People's Income And Higher Inflation

Consequently, growth of output per hour worked (productivity) has slowed (Chart 7), in sharp contrast to previous business expansion (Chart 8).

The slower growth of productivity during the economic recovery of 1975 through 1979 compared to other economic recoveries and compared to the 20-year productivity growth of the 1950's and 1960's means that the average American household is receiving about $2,500 smaller incomes during 1979 than the average household would have received if productivity growth had not slowed. In large part, slower productivity growth has been caused by low growth of investment which in turn was caused by the declining real profits from current production.

Also, the slower productivity growth has helped to cause consumer price inflation. If productivity growth were to match the experience of the 1950's and the 1960's, inflation rates could be brought down by 1 to 2 percent in 1979, 2 to 4 percent in 1980, and 3 to 7 percent in 1981. This could be the fastest way for the United States to return to price stability.

The fact that an average American household is receiving $2,500 less income during 1979 than it would have received if profits had remained normal has led to a lower American standard of living, e.g. American households could be enjoying more adequate housing, clothing and food than they now enjoy. In the case of housing this could have meant 3 million additional housing units could have been built and housing starts might have been closer to 2 million units this year instead of the forecast addition of 1.7 million housing starts. This increased housing production would have eased much of the current housing shortage and reduce inflation and home prices by several percentage points.

Thus, the decline in real profits from current production is a significant cause of both high inflation and a lower standard of living for all Americans. If real profits had been normal, undoubtedly the number of people in poverty would have been greatly reduced.

TABLE 1

PROFITS OF ALL U.S. CORPORATIONS
(NIA Basis, Billions of Dollars)

	Actual				Estimated		
	1stQ 1979	2ndQ 1979	Change $	Change %	3rdQ 1979	Change $	Change %
(1) Pretax profits, current $	233	227	-6	-10.5	224	-3	-4.6
(2) Less: Profits tax liability	91	88	-3	-12.5	88	0	-0.5
(3) Equals: After tax profits	142	139	-3	-9.2	136	-3	-7.1
Inflation Adjustments							
(4) Inventory valuation adjustment	-41	-37	3		-42	-5	
(5) Capital consumption adjustment	-15	-15	0		-17	-3	
(6) Equals: Profits from current production	88	87	1	-1.4	77	-10	-39.8
(7) Profits from current production, constant $1978	83	81	-2	-11.0	70	-11	-45.2
Gross National Product Volume Adjustment 1/							
(8) Profits from current production	3.8	3.7		-7.5	3.3		-43.3
(9) Total employee compensation	61.6	61.8		1.5	62.3		3.5
(10) Total government taxes	35.7	35.8		0.4	35.7		-0.9
Gross Domestic Product Volume Adjustment 2/							
(11) Compensation of employees	107.5	110.5		11.6	113.0		9.4
(12) Corporate profits with inventory valuation and capital consumption adjustments	16.0	15.7		-7.1	13.9		-38.2
(13) Profits tax liability	8.8	8.5		-13.9	8.2		-13.3
(14) Profits after tax with inventory valuation and capital consumption adjustments	7.1	7.2		1.8	5.7		-60.3

1/ Current dollar cost and profit in all U.S. corporations per unit of current dollar gross national product.
2/ Current dollar cost and profit of non-financial corporations per unit of constant dollar gross domestic product of non-financial corporations. Commerce Department's method of calculating volume adjustments.

Source: Actual data from the Department of Commerce. Estimated data from the National Association of Realtors.

TABLE 2

PROFITS OF ALL U.S. CORPORATIONS
(NIA Basis, Billions of Dollars)

		Actual				Estimated			
	1stQ 1978	2ndQ 1978	2ndQ 1979	Change $	Change %	3rdQ 1978	3rdQ 1979	Change $	Change %
(1) Pretax profits, current $	178	207	227	20	9.5	212	224	12	5.8
(2) Less: Profits tax liability	71	85	88	4	4.1	87	88	1	0.9
(3) Equals: After tax profits	107	122	139	16	13.2	125	136	11	9.2
Inflation Adjustments									
(4) Inventory valuation adjustment	-24	-25	-37	-12		-23	-42	-19	
(5) Capital consumption adjustment	-12	-13	-15	-2		-14	-17	-4	
(6) Equals: Profits from current production	71	84	87	3	3.1	88	77	-11	-12.4
(7) Profits from current production, constant $1978	72	86	81	-4	-5.3	87	70	-17	-19.7
Gross National Product Volume Adjustment 1/									
(8) Profits from current production	3.5	4.0	3.7		-6.9	4.1	3.3		-20.0
(9) Total employee compensation	61.9	61.2	61.8		0.9	61.2	62.3		1.9
(10) Total government taxes	35.6	35.9	35.8		-0.4	35.8	35.7		-0.4
Gross Domestic Product Volume Adjustment 2/									
(11) Compensation of employees	100.2	100.9	110.5		9.5	102.4	113.0		10.3
(12) Corporate profits with inventory valuation and capital consumption adjustments	13.2	15.9	15.7		-1.2	16.3	13.9		-14.7
(13) Profits tax liability	7.1	8.5	8.5		-0.1	8.6	8.2		-4.8
(14) Profits after tax with inventory valuation and capital consumption adjustments	6.0	7.4	7.2		-2.6	7.7	5.7		-25.8

1/ Current dollar cost and profit in all U.S. corporations per unit of current dollar gross national product.
2/ Current dollar cost and profit of non-financial corporations per unit of constant dollar gross domestic product of non-financial corporations. Commerce Department's method of calculating volume adjustments.

Source: Actual data from the Department of Commerce. Estimated data from the National Association of Realtors.

TABLE 3

PROFITS OF ALL U.S. CORPORATIONS
(NIA Basis, Billions of Dollars)

	Previous 4 Quarters (77:3 to 78:2)	Last 4 Quarters (78:3 to 79:2)	Change $	Change %	Next 4 Quarters (79:3 to 80:2)	Change $	Change %
(1) Pretax profits, current $...	187	225	38	20.2	227	2	0.8
(2) Less: Profits tax liability...	76	91	14	19.0	89	-1	-1.5
(3) Equals After tax profits...	111	134	23	21.0	138	3	2.4
Inflation Adjustments							
(4) Inventory valuation adjustment...	-19	-32	-13		-38	-6	
(5) Capital consumption adjustment...	-12	-14	-2		-22	-8	
(6) Equals: Profits from current production...	80	88	9	10.1	78	-10	-11.9
(7) Profits from current production, constant $1978	83	85	2	2.5	68	-17	-19.6
Gross National Product Volume Adjustment 1/							
(8) Profits from current production...	4.0	3.9		-2.1	3.2		-18.7
(9) Total employee compensation...	61.2	61.4		0.3	62.5		1.8
(10) Total government taxes...	35.6	35.8		0.6	35.6		-0.7
Gross Domestic Product Volume Adjustment 2/							
(11) Compensation of employees...	98.5	106.1		7.7	116.3		9.5
(12) Corporate profits with inventory valuation and capital consumption adjustments...	15.0	16.2		8.0	13.9		-14.6
(13) Profits tax liability...	7.8	8.8		12.9	8.2		-6.8
(14) Profits after tax with inventory valuation and capital consumption adjustments...	7.2	7.4		2.6	5.7		-23.8

1/ Current dollar cost and profit in all U.S. corporations per unit of current dollar gross national product.
2/ Current dollar cost and profit of non-financial corporations per unit of constant dollar gross domestic product of non-financial corporations. Commerce Department's method of calculating volume adjustments.

Source: Actual data from the Department of Commerce. Estimated data from the National Association of Realtors.

TABLE 4

PROFITS OF ALL U.S. CORPORATIONS
(NIA Basis, Billions of Dollars)

	Actual				Estimated			Projected		
	Year 1977	Year 1978	Change $	Change %	Year 1979	Change $	Change %	Year 1980	Change $	Change %
(1) Pretax profits, current $...	177	206	29	16.3	227	21	10.4	237	10	4.2
(2) Less: Profits tax liability...	73	85	12	16.4	89	5	5.5	93	4	4.5
(3) Equals: After tax profits...	104	121	17	16.3	138	17	13.9	144	6	4.1
Inflation Adjustments										
(4) Inventory valuation adjustment...	-15	-25	-10		-40	-14		-36	4	
(5) Capital consumption adjustment...	-12	-13	-1		-17	-4		-28	-11	
(6) Equals Profits from current production...	77	83	6	7.5	81	-1	-1.5	80	-1	-1.5
(7) Profits from current production, constant $1978	83	83	0	0.2	75	-8	-9.6	68	-7	-9.9
Gross National Product Volume Adjustment 1/										
(8) Profits from current production...	4.1	3.9		-4.0	3.5		-10.8	3.1		-10.1
(9) Total employee compensation...	60.9	61.3		0.7	61.1		1.2	62.3		0.4
(10) Total government taxes...	35.5	35.9		1.1	35.7		-0.5	35.6		-0.4
Gross Domestic Product Volume Adjustment 2/										
(11) Compensation of employees...	95.1	102.0		7.3	111.7		9.6	120.4		7.7
(12) Corporate profits with inventory valuation and capital consumption adjustments...	15.1	15.6		3.5	14.5		-7.3	14.8		2.3
(13) Profits tax liability...	7.7	8.4		8.5	8.3		-1.1	8.6		4.1
(14) Profits after tax with inventory valuation and capital consumption adjustments...	7.4	7.2		-1.9	6.2		-14.5	6.2		-0.1

1/ Current dollar cost and profit in all U.S. corporations per unit of current dollar gross national product.
2/ Current dollar cost and profit of non-financial corporations per unit of constant dollar gross domestic product of non-financial corporations. Commerce Department's method of calculating volume adjustments.

Source: Actual data from the Department of Commerce. Estimated data from the National Association of Realtors.

CHART 1

CORPORATE PROFITS AFTER TAX
AS A PERCENT OF GROSS NATIONAL PRODUCT

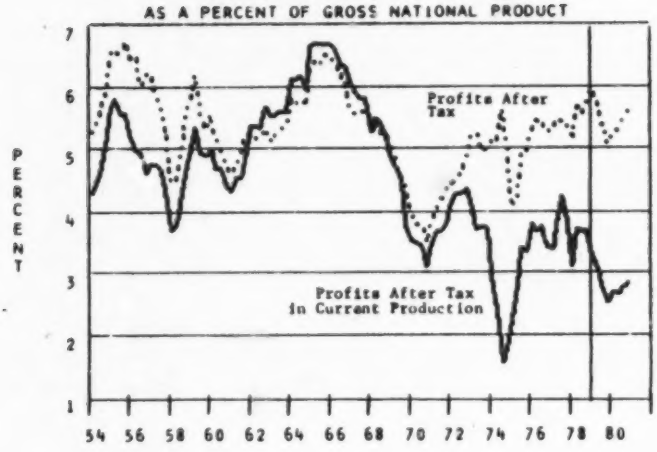

CHART 2

CORPORATE PROFITS AFTER TAXES IN
CURRENT PRODUCTION AS A PERCENT OF GNP
DURING CURRENT AND 1961 BUSINESS RECOVERIES
(1975:1 = 100)

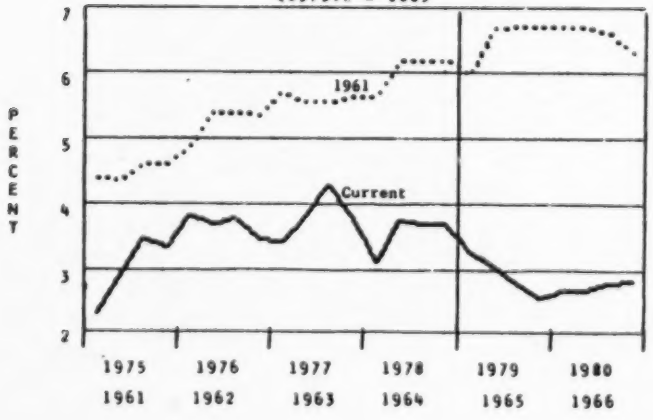

CHART 3

NOMINAL AND EFFECTIVE CORPORATE TAX RATES

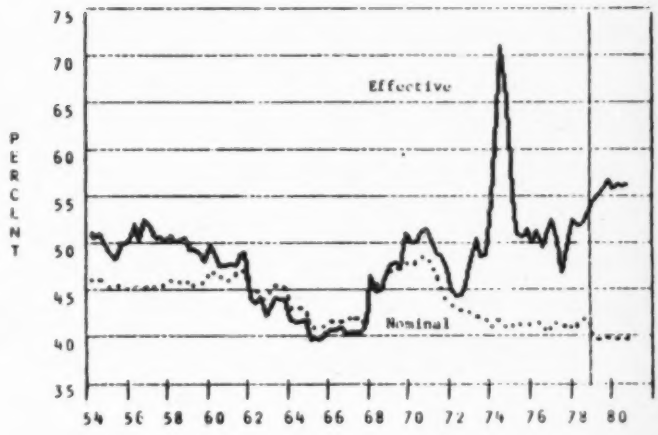

CHART 4

EFFECTIVE CORPORATE TAX RATE
DURING CURRENT AND 1961 BUSINESS RECOVERIES

1975:1 = 100

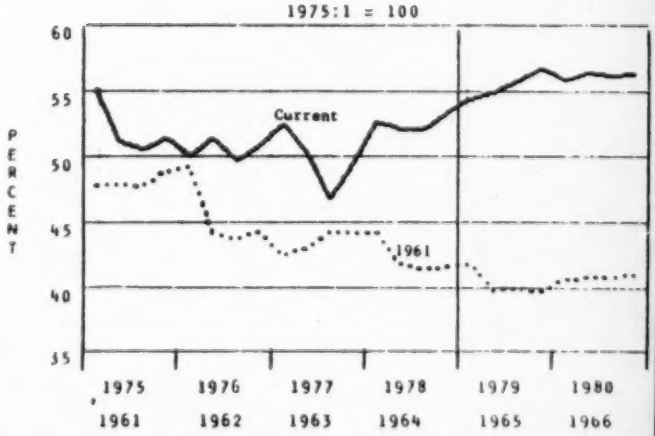

CHART 5

REAL NET CAPITAL STOCK PER EMPLOYEE
(NON-FARM BUSINESS SECTOR)

(1954:1=100)

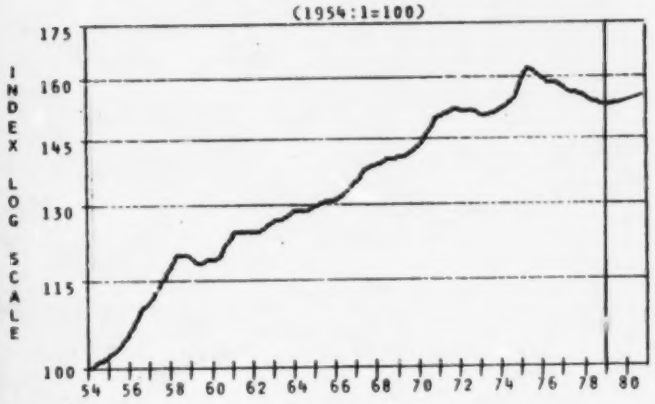

CHART 7

REAL NET CAPITAL STOCK PER EMPLOYEE
AND OUTPUT PER HOUR WORKED (PRODUCTIVITY)
(NON-FARM BUSINESS SECTOR)

(1954:1=100)

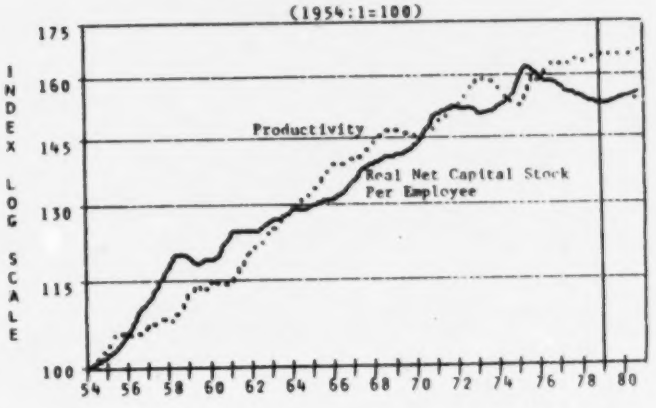

CHART 6

REAL NET CAPITAL STOCK PER EMPLOYEE
DURING CURRENT AND 1961 RECOVERIES
(1975:1 = 100)

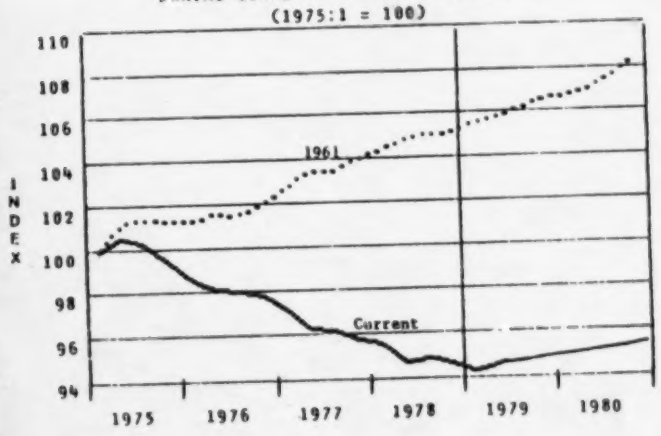

CHART 8

OUTPUT PER HOUR WORKED (PRODUCTIVITY) IN THE
NON-FARM BUSINESS SECTOR DURING CURRENT AND 1961
(1975:1 = 100)

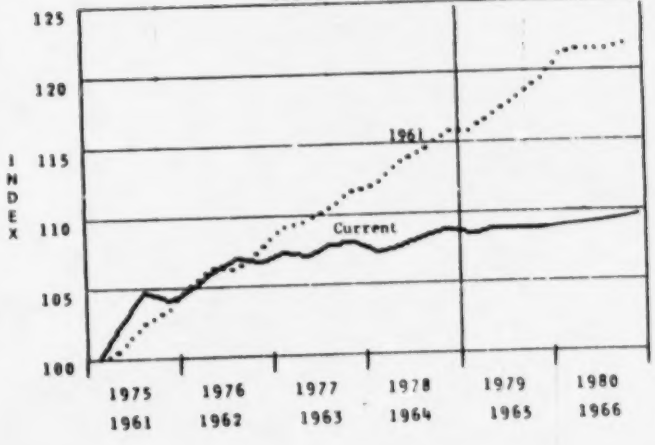

TABLE 5

FORM BE-881
(REV. 4-77)

U.S. DEPARTMENT OF COMMERCE
BUREAU OF ECONOMIC ANALYSIS

NATIONAL INCOME BY TYPE OF INCOME
(Billions of dollars)

	1976	1977	1978	1978 II	1978 III	1978 IV	1979 I	1979 II
				Seasonally adjusted at annual rates				
National Income	1,359.8	1,525.8	1,724.3	1,703.9	1,752.5	1,820.0	1,869.0	1,897.0
Compensation of employees	1,037.8	1,156.9	1,304.5	1,288.2	1,321.1	1,364.8	1,411.2	1,439.4
Wages and salaries	890.0	984.0	1,103.5	1,090.0	1,117.4	1,154.7	1,189.4	1,211.3
Government and government enterprises	188.0	201.3	218.0	215.3	219.2	225.1	228.1	231.2
Other	702.0	782.7	885.5	874.6	898.1	929.6	961.3	980.1
Supplements to wages and salaries	147.8	172.9	201.0	198.3	203.7	210.1	221.8	228.2
Employer contributions for social insurance	70.4	81.2	94.6	93.6	95.5	98.2	105.8	107.8
Other labor income	77.4	91.8	106.5	104.7	108.2	111.9	116.0	120.3
Proprietors' income with inventory valuation and capital consumption adjustments	89.3	100.2	116.8	115.0	117.4	125.7	129.0	129.2
Farm	18.3	19.6	27.7	27.7	26.1	31.3	34.2	33.7
Nonfarm	71.0	80.5	89.1	87.3	91.3	94.4	94.8	95.5
Rental income of persons with capital consumption adjustment	22.1	24.7	25.9	24.4	26.8	27.1	27.3	26.8
Corporate profits with inventory valuation and capital consumption adjustments	126.8	150.0	167.7	169.4	175.2	184.8	178.9	175.5
Profits before tax	156.0	177.1	206.0	207.2	212.0	227.4	233.3	226.9
Profits tax liability	63.8	72.6	84.5	84.7	87.5	95.1	91.3	88.2
Profits after tax	92.2	104.5	121.5	122.4	124.6	132.3	142.0	138.6
Dividends	37.5	42.1	47.2	46.0	47.8	49.7	51.5	52.3
Undistributed profits	54.7	62.4	74.3	76.4	76.8	82.6	90.5	86.3
Inventory valuation adjustment	-14.6	-15.2	-25.2	-25.1	-23.0	-28.8	-39.9	-36.6
Capital consumption adjustment	-14.5	-12.0	-13.1	-12.6	-13.8	-13.8	-14.5	-14.7
Net interest	83.8	94.0	109.5	106.8	111.9	117.6	122.6	126.0
Addenda:								
Corporate profits with inventory valuation and capital consumption adjustments	126.8	150.0	167.7	169.4	175.2	184.8	178.9	175.5
Profits tax liability	63.8	72.6	84.5	84.7	87.5	95.1	91.3	88.2
Profits after tax with inventory valuation and capital consumption adjustments	63.0	77.3	83.2	84.7	87.8	89.8	87.6	87.3
Dividends	37.5	42.1	47.2	46.0	47.8	49.7	51.5	52.3
Undistributed profits with inventory valuation and capital consumption adjustments	25.5	35.2	36.0	38.7	40.0	40.1	36.1	35.0

USCOMM-DC 43981-p78

Source: U. S. Department of Commerce's Corporate Profits Release for the Second Quarter of 1979, released 9:30 A.M. Friday, August 17, 1979.

TABLE 6

FORM BE-729
(8-21-78)

U.S. DEPARTMENT OF COMMERCE
BUREAU OF ECONOMIC ANALYSIS

GROSS DOMESTIC PRODUCT OF NONFINANCIAL CORPORATE BUSINESS

	1976	1977	1978	1978 II	1978 III	1978 IV	1979 I	1979 II
				Seasonally adjusted at annual rates				
				Billions of dollars				
Gross domestic product of nonfinancial corporate business	988.0	1,106.3	1,246.9	1,236.5	1,267.9	1,314.1	1,346.4	1,368.7
Capital consumption allowances with capital consumption adjustment	106.8	116.0	126.9	125.8	128.2	130.5	133.4	138.4
Net domestic product	881.2	990.3	1,120.0	1,110.8	1,139.7	1,183.5	1,213.0	1,230.4
Indirect business taxes plus transfer payments less subsidies	99.8	107.8	117.2	117.4	117.5	120.7	122.8	124.2
Domestic income	781.5	882.5	1,002.7	993.4	1,022.2	1,062.8	1,090.2	1,106.2
Compensation of employees	650.2	732.6	834.7	824.6	846.5	876.5	910.0	928.1
Wages and salaries	550.2	615.3	697.8	689.5	707.6	733.0	758.3	772.2
Supplements to wages and salaries	100.0	117.3	137.0	135.1	138.9	143.6	151.7	155.9
Corporate profits with inventory valuation and capital consumption adjustments	100.9	116.5	128.3	130.0	135.1	143.8	135.9	132.5
Profits before tax	130.0	143.5	166.1	167.3	171.3	185.7	189.5	182.9
Profits tax liability	52.5	59.6	68.8	69.5	71.2	77.9	74.7	71.3
Profits after tax	77.4	83.8	97.4	97.8	100.1	107.8	114.8	111.5
Dividends	33.1	37.2	41.8	40.0	42.8	44.1	46.2	47.4
Undistributed profits	44.3	46.6	55.5	57.7	57.3	63.7	68.6	64.2
Inventory valuation adjustment	-14.6	-15.2	-25.2	-25.1	-23.0	-28.8	-39.9	-36.6
Capital consumption adjustment	-14.4	-11.8	-12.6	-12.1	-13.2	-13.1	-13.6	-13.8
Net interest	30.4	33.4	39.7	38.8	40.6	42.4	44.2	45.5
				Billions of 1972 dollars				
Gross domestic product of nonfinancial corporate business	730.4	770.7	818.7	817.1	826.3	841.4	846.6	840.1
				Dollars				
Current dollar cost and profit per unit of constant dollar gross domestic product	1.353	1.436	1.523	1.513	1.535	1.562	1.590	1.629
Capital consumption allowances with capital consumption adjustment	.146	.151	.155	.154	.155	.155	.158	.165
Net domestic product	1.206	1.285	1.368	1.359	1.379	1.407	1.433	1.464
Indirect business taxes plus transfer payments less subsidies	.137	.140	.143	.144	.142	.143	.145	.148
Domestic income	1.070	1.145	1.225	1.216	1.237	1.263	1.288	1.317
Compensation of employees	.890	.951	1.020	1.009	1.024	1.042	1.075	1.105
Corporate profits with inventory valuation and capital consumption adjustments	.138	.151	.157	.159	.163	.171	.161	.158
Profits tax liability	.072	.077	.084	.085	.086	.093	.088	.085
Profits after tax with inventory valuation and capital consumption adjustments	.066	.074	.073	.074	.077	.078	.072	.073
Net interest	.042	.043	.048	.047	.049	.050	.052	.054

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Source: U. S. Department of Commerce's Corporate Profits Release for the Second Quarter of 1979, released 9:30 A.M. Friday, August 17, 1979.